Ministerial Capability, Capital Shape and Resistant Value

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Abstract

With the reform of our property rights system, the maturity of the capital market, and the diversification of corporate financing, the capital Shape decision has become the major concern of financial management. There are numbers of researches on how to determine the optimal capital Shape, what factors affect the capital Shape and what the relationship is like between the capital Shape and the Resistant value. Built upon prior literature, this paper investigates how Ministerial Capability influences the capital Shape with the operation risks and the characteristics of the directors' Shape. We find that the capital Shape deviates from the optimal level more in resistant's with stronger Ministerial Capability, and hose Resistant's have a stronger discount on such deviation.

Keywords:- Ministerial Capability, Capital Shape, Resistant Value.

Introduction

With the accomplishment of the reform of the corporate property rights system, housing system and banking system, the Chinese capital market is gradually becoming mature and diversified financial instruments are emerging. The state-owned enterprise property rights reform and the collectively-owned enterprise restructuring have dramatically changed the capital Shape of Chinese enterprises. The intensifying banking reform has in-creased the liquidity of credit funds. The funds are gradually centralized in the large-scale and preponderant enterprises. Thus, the reform provides financial leverage for the increase of the industrial capital. As an indicator of the rights and obligations of the corporate stakeholders, the capital Shape is considered as the major measure of the corporate financing decisions. The corresponding capital Shape theories are generally recognized as the footstones for the modern financial management theories, receiving widespread concerns from home and abroad. The core problem worth solving is whether and how the capital Shape will influence the resistant value and then whether there exists an optimal capital Shape. However, due to the special institutional environment in China, the capital market is still imperfect and the investors are under relatively poor protection. Thus, companies strongly

prefer equity financing. In this situation, the financing activities are often turned out to be the capital operations of the listed companies.

Researches on capital Shape include the traditional corporate finance, agency theory and behavioral finance. The traditional corporate finance discusses how to determine the optimal capital Shape. Modigliani and Miller (1958) [1] raised the Capital Shape Irrelevance Theory, which contends that in the perfect market, the capital Shape is irrelevant to the Resistant value. The Principal-Agent Theory put forward by Jensen and Mackling (1976)[2] pays attention to the influence of a specific corporate mechanism (e.g. management shareholding, share holders' dual identity of managers) on the capital Shape. And the behavioral finance has introduced the way of analysis in organizational behavior, and showed its concern on the financial decisions under the managers' overconfidence. Based on the past researches, this paper analyzes the relationship between the Ministerial Capability and the capital Shape from the perspective of overconfidence and explores the marginal effect of the Ministerial Capability on the capital Shape considering the pathway through which the capital Shape affects the Resistant value.

Theoretical Analysis and Research Hypothesis Based on the research by Fast et al. (2012) [3], our research refers to the analysis about the manager over confidence by Hack Barth (2008) [4], Malmendier et al. (2009) [5] and gets to the specific decision making process for the capital Shape. Because managers with the almighty Capability tend to overestimate the net present value of the investment projects, they think that the external market (especially the stock market) underestimates the resistant value and therefore favor internal retained earnings as the way of financing. Compared to those companies with enough cash flows, these companies are more conservative regarding debt financing. This kind of situation is more commonly seen in the Chinese capital market with insufficient protection for investors. But for those companies whose retained earnings cannot satisfy their investment, they may adopt some radical debt financing strategies. Therefore, whether debt conservatism or radical financing strategies show that overconfidence driven by concentrated Capability will lead managers to the capital Shape decisions that deviate from the optimal capital Shape determined by the traditional framework and thus this reflects the irrational features of decisions. Based on the analysis above, this paper raises the following hypothesis 1: Ceteris paribus, the stronger the managerial Capability is, the more deviated the capital Shape is from the optimal one. Strong control Capability leads to biased estimates about the external financing costs and thus the managers may make capital Shape decisions that deviate from the optimal one. But under the debt conservatism, investors will not change their expectations about the real risks of the investment projects regardless of this irrational capital Shape decision and still require the corresponding investment returns. Under the radical debt financing condition, the corporate financial crisis costs will be raised and thus

the general equity capital costs will increase, leading to the loss of the resistant value. This theory provides a new thought to understand the value effect of the capital structure from the perspective of the drives for decision making. Based on the analysis above, this paper raises the following hypothesis 2: *Ceteris paribus*, the stronger the Ministerial Capability is, the stronger the discount effect is.

Data Analysis and Result Explanation

The research uses panel data models, and verifies that the random effect model needs to be used through the Housman Test. Corresponding coefficients are tested by Z-test. As shown in Table 2, the management board centralization and the chairman's absolute shareholding ratio are both significantly positively related to the deviation of leverage ratio the deviation of ratio of liabilities with interests and the deviation of short-term liability ratio. And the regression coefficients is 0.0004 and 0.051, 0.002 and 0.018, 0.001 and 0.003, separately. The significantly positive coefficients indicate that *ceteris paribus*, the stronger the Ministerial Capability is, the more deviated the capital Shape is from the optimal one, and therefore, prove that the stronger Ministerial Capability will lead to irrational capital Shape decisions. As shown in Table 3, the coefficients of the variables for the capital Shape dimension all have a negative sign, which indicates that the deviation from the optimal capital Shape will lead to a discount of the Resistant value. The paper pays attention to the sign of the multiplicative interaction term by the Ministerial Capability variables and the capital Shape variables. When the deviation of leverage ratio is used to measure the capital Shape deviation, the coefficients of the two multiplicative interaction terms are -0.022 and -0.429 with the significant level at 10% and 1% respectively; when the deviation of ratio of liabilities with interests 0 is used, the coefficients are -0.004 and -0.451 with the significant level at 10% and 5% respectively; when the deviation of short-term liability ratio is used, the coefficients are -0.015 and -0.374 with the significant level at 10% and 10% respect timely. The regression results indicate that *ceteris paribus*, the stronger the Ministerial Capability is, the stronger the discount effect of the deviation of the capital Shape is.

Conclusions and Suggestions The paper studies the influence of the Ministerial Capability on the company capital Shape using the data from the listed companies in the Shanghai and Shenzhen A-share market in China. From the perspective of managerial Capability, the paper borrows the analysis framework for the Capability controller's psychological mechanism by Fast et al. (2012) [3], and points out that the centralization of the Ministerial Capability will lead to overconfident financing decisions made by the management board so that the capital Shape will be the sub-optimal one, deviated from the optimal one. Meanwhile, the paper analyzes how the Ministerial Capability impairs the resistant value by affecting the capital Shape decisions, which provides empirical evidence for investors to identify the dynamic features of Ministerial Capability

financing and its influence on the resistant value. The research has found that ceteris paribus, the stronger the Ministerial Capability is, the more deviated the capital Shape is from the optimal one, and the stronger the discount effect is. As suggested in this paper, when evaluating the investment value of a company's stocks, investors should concern for not only the indicators for the capital Shape, but also the Capability execution features of the organization, and pay attention to the influence of the Ministerial Capability on the decision making process and the influence of the Capability distribution on the deviation of the capital Shape from the industry target in order to make a reasonable prediction for the Resistant performance in the future.

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